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IN THE

MICHAEL ROBAK, JR., CLERK

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79 - 407

HARRY HARPER WAGNER AND RUTH WAGNER,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE THIRD CIRCUIT**

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IN THE
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No. _____

HARRY HARPER WAGNER and RUTH WAGNER,

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v.

COMMISSIONER OF INTERNAL REVENUE,

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PETITION FOR A WRIT OF CERTIORARI
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Petitioners Harry Harper Wagner and Ruth Wagner pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit affirming a decision rendered by the United States Tax Court.

OPINIONS BELOW

The judgment order of the Court of Appeals, which is unreported, is set out in the Appendix, infra, p. 1a. The memorandum opinion of the Tax Court, which is reported at T.C. Memo. 1978-49 is set out in the Appendix, infra, p. 2a.

JURISDICTION

The judgment of the Third Circuit Court of Appeals was entered on June 13, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether in a net worth case, where the trier of fact finds that the testimony of the taxpayer concerning a cash hoard is insufficient to overcome the presumption of correctness attached to the government's deficiency allegation, the taxpayer may directly challenge the deficiency and indirectly prove the existence of his cash hoard, thereby overcoming the presumption, by demonstrating he could not have earned the taxable income alleged?

2. Whether in a net worth case, where the government has the burden to prove fraud so that the case against the taxpayer is not barred by the statute of limitations, and where the existence of a deficiency is essential to the government's proof of fraud, an affirmative showing on the part of the taxpayer that he had one source of income and that it was incapable of producing the income alleged by the deficiency requires a finding on this issue since the evidence tends to prove that the government did not carry its burden.

STATUTE INVOLVED

Internal Revenue Code, Title 26:

§6501(a). General Rule.--Except as otherwise provided in this section, the amount of any tax imposed by this

title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * *

\$6501(c). Exceptions.--

(1) **False Return.** In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

STATEMENT OF THE CASE

The taxpayer is a butcher and grocer in Hershey, a small rural town in central Pennsylvania. For about two and one half of the three years in question, 1959 through 1961, the taxpayer operated a small, corner grocery store and peddled meat from door to door. In 1961 he built and equipped a larger store which despite its greater size continued to operate more as a convenience store specializing in meats than a supermarket. The taxpayer concentrated his efforts on his new store and discontinued his peddle route at that time.

The taxpayer, his wife and son operated the grocery and butcher business with occasional

help from the taxpayer's brother and sister-in-law. The taxpayer lived very frugally and did not take vacations. The taxpayer had a reputation as a hard worker who devoted all his time and energy to his business. There was no allegation by the government that the taxpayer had any other source of income not revealed at trial. By use of a net worth analysis, the government alleged that the taxpayer understated his income from these sources in the amount of \$41,828.49, \$80,821.05 and \$50,985.61 in the years 1959, 1960 and 1961, respectively. The government also alleged that the understatement of income was due to fraud. A determination of fraud is critical in this case since, without such a finding, the deficiency assessment would be barred by the statute of limitations.

An area of contention involves the attempts by the taxpayer to demonstrate both by direct evidence and inference that his apparent increases in net worth resulted from a previously existing cash accumulation. The taxpayer testified at trial concerning the details of his cash hoard, the sources from which it was derived, and his reasons for failing to disclose the cash hoard to IRS agents during the early stages of the investigation. In addition, the taxpayer introduced evidence to show that he dealt almost exclusively in cash and frequently carried large sums of cash. Even though the Tax Court recognized the "extraordinary nature of the individual taxpayer," it did not believe that a substantial cash hoard existed at the beginning of the period in question.

The taxpayer further sought to discredit the deficiency and indirectly prove the existence of his cash accumulation by demonstrating it was impossible for him to have earned the amount of understated income alleged by the government. Records regarding inventory, costs of goods sold and store volume were introduced. Expert testimony

was heard regarding the profit margin for similar stores in the area and the maximum profit which could have been obtained from stores similar to the taxpayer's. The government recognized at trial the importance of this information and presented its own evidence concerning the income-producing capacity of the store. Despite the importance both parties attached to the resolution of this issue as proof of any deficiency, the Tax Court did not determine whether it was possible for the taxpayer to have earned the alleged deficiencies.

The Tax Court failed to make any finding of fact which relates to the economic questions of this case: How does a man, his wife and son (along with some part-time help) who operate a small grocery store with a one-man meat peddle route on the side earn \$205,467.77 in taxable income (\$31,832.62 reported and allegedly \$173,635.15 unreported) from 1959 through 1961 when a dollar had more than twice the purchasing power it has today? Why did the huge amounts of alleged unreported income stop in 1961? Why was there approximately \$42,000.00 in alleged unreported income in 1959 and approximately \$81,000.00 in 1960? All of these questions remain unanswered; nevertheless, the Tax Court held the government proved the deficiencies which were essential elements in the court's finding of fraud.

REASONS FOR GRANTING THE WRIT

1. Substantial injustice will result from the use of the net worth method unless this Court determines that all circumstantial evidence tending to disprove a net worth deficiency must be evaluated by the trier of fact.

In Holland v. United States, 348 U.S. 121 (1954), this Court approved the government's use of the net worth method to prove tax deficiencies. The Court recognized that proof of a tax deficiency by this form of circumstantial evidence was "fraught with danger for the innocent"^{1/} and warned trial courts to "closely scrutinize its use."^{2/} The Court held that the government must meet certain procedural safeguards in order to justify its use of the net worth method. One requirement placed on the government is the duty to show a "likely source" of the alleged deficiency. In a subsequent decision, United States v. Massei, 355 U.S. 595 (1958), the Court held that the government need not always prove a likely source; it could also attribute net worth increases to current taxable income by negating all nontaxable sources of income. Thus, the government is equipped with a "two-edged sword" ^{3/} in its battle to uncover tax evaders.

An issue not adequately considered in Holland or Massei and one which is treated inconsistently by the Circuits, concerns the quality and quantity of proof that the taxpayer must provide to overcome the presumption of correctness accorded a deficiency based upon the net worth method or to cast sufficient doubt on the results of the method when the government bears the burden in a fraud case. This problem often arises when a taxpayer claims that the increase in his net worth is due to a previously existing cash hoard. The claim of an honest taxpayer who lived modestly and accumulated a cash hoard is unfairly compromised because this

^{1/} Holland, 358 U.S. at 125.

^{2/} Id.

^{3/} United States v. Bethea, 537 F.2d 1187, 1191 (4th Cir. 1976).

"favorite defense"^{4/} is overused and frequently asserted frivolously.^{5/} As noted in Holland, a taxpayer "may be entirely honest and yet unable to recount his financial history".^{6/} If the taxpayer's testimony regarding his cash hoard is insufficient to overcome the presumption accorded the deficiency determination of the government, the tax court must rule against the taxpayer. However, in such a case the taxpayer should also be permitted to address directly the ultimate issue--the existence of taxable income during the period in question.

Whereas Massei permits the proof of nonreported taxable income by the negation of all nontaxable sources, the taxpayer must also be allowed to challenge this finding with circumstantial evidence. A taxpayer's assertion that his taxable income during the period in question could not possibly support the alleged deficiency addresses the question of unreported taxable income directly and bears indirectly on the likelihood of a cash hoard. To make this claim, the taxpayer would necessarily bear the burden to persuade the tax court that the source of income he alleges is his sole source of income and that it was not possible for that source to generate the amount of income alleged in the deficiency. As the First Circuit stated in Commissioner of Internal Revenue v. Thomas, 261 F.2d 643 (1st. Cir.1958):

if the taxpayer in a net worth case chooses to assume, and sustains, the burden of negating by a

4/ Holland, 348 U.S. at 127

5/ See Bethea, 537 F.2d at 1189-90;
Gunn v. Commissioner, 247 F.2d 359, 362 (8th Cir. 1957).

6/ Holland, 348 U.S. at 128.

preponderance of the evidence all possible sources of taxable income, he has, of logical necessity, proved the Commissioner to be in error and is entitled to prevail. Cf. United States v. Massei. (Citation omitted.)

The issue raised by this case occurs when a taxpayer elects to challenge the net worth deficiency with an affirmative showing regarding his possible sources of income and the tax court makes no finding on this issue but instead upholds the deficiency because it does not believe the taxpayer's explanation concerning his cash horde. The failure of the trial court to rule upon this defense should be reversible error.^{7/} In a case where the taxpayer must overcome the presumption accorded a deficiency assessment, circumstantial evidence contradicting the government's circumstantial evidence developed

7/ See Holland, 348 U.S. at 135: "When the government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt."

Concerning the charges to accompany a net worth deficiency allegation the Court, 348 U.S. at 129 states: "[c]harges should be especially clear, including,...the inferences available both for and against the accused."

by the net worth method should be sufficient to show the government's determination was incorrect.^{8/}

Where the government bears the burden to prove fraud by clear and convincing evidence, such evidence contradicting the government's deficiency allegation should be sufficient to demonstrate the government failed to carry its burden.

2. No consensus exists among the Courts of Appeals regarding the treatment accorded circumstantial evidence contradicting net worth deficiencies.

Taxpayers have attempted to rebut deficiency determinations based upon the net worth analysis in two ways. They have introduced evidence demonstrating their sole source of income could not generate the alleged deficiency and they have claimed that the alleged amount, even if earned, was not identifiable to the period in question.

In Commissioner of Internal Revenue v. Thomas, 261 F.2d 643, 645 (1st Cir. 1952), the First Circuit stated that a taxpayer who carries the burden to prove that the deficiency exceeds his maximum possible income is entitled to prevail. The Fourth Circuit in United States v. Bethea, 537 F.2d 1182, 1191 (4th Cir. 1976), suggested the same result where evidence is introduced tending to show that taxable income during the period in question was small and therefore any taxable income would have been earned in prior years.

^{8/} Once the deficiency is shown to be incorrect, the duty would shift to the government to produce additional evidence as to the deficiency although the burden of persuasion remains with the taxpayer. See Weir v. Commissioner, 283 F.2d 675, 682 (6th Cir. 1960).

The Ninth Circuit decision Whitfield v. United States, 383 F.2d 142 (9th Cir. 1967), appears to require a showing of good faith on the part of the taxpayer before it will make a finding on his claim that his business could not earn the alleged deficiency. The court notes that the taxpayer destroyed motel reservation cards which might have supported or undermined the contention that the business enterprise could not produce the amounts of unreported income claimed by the government.^{9/}

The Second and Sixth Circuits have dismissed claims that the lower court's decision does not comport with the economic realities of the taxpayer's business apparently on the basis that Massei does not require the government to prove a likely source. Yet, both Circuits seem compelled to review the evidence regarding the income producing capacity of these businesses to fill in the logical gap in the case. In Foster v. Commissioner, 487 F.2d 902, 930 (6th Cir. 1973) the court determined that the business was "capable of producing large profits" during the period in question. The Second Circuit decision, United States v. Costanzo, 581 F.2d 28, 22 (2d Cir. 1978), cert. denied, 99 S. Ct. 833 (1979), found that the taxpayer's business could produce "at least a substantial portion of the unreported income..." The court notes however, that the defense failed to provide the information necessary to determine the profitability of the business. Id. at 33.

3. The decision below raises significant and recurring problems concerning the sufficiency of evidence needed to invalidate a deficiency established by the net worth method.

^{9/} The court declined to rule on this fact despite evidence introduced by both the taxpayer and the government. Whitfield, 383 F.2d at 144.

The treatment accorded the efforts of this taxpayer to challenge both the deficiency determination and the finding of fraud based on the government's net worth analysis raises serious questions about the way this Court's directions contained in Holland and Massei are applied. The efforts of a taxpayer to demonstrate no possible source of taxable income has received short shrift from the Tax Court and Appellate Courts apparently because the net worth method has taken on greater significance than the circumstantial evidence it creates. Since this Court has not had an opportunity to review the application of the procedural framework it established in Holland and Massei or the effect of the warnings contained in those cases, it is appropriate at this time that such analysis be undertaken.

Even at the time Holland was decided, the Court recognized that the net worth method had evolved from a method to corroborate direct proof of specific unreported income to the government's first line of attack against tax evasion even in the ordinary income brackets. The net worth method has substantial importance to the proper administration of both the internal revenue code and criminal statutes relating to tax fraud. Although this case involves civil penalties, the legal questions raised have broader significance since the use of the net worth method to prove deficiencies in both areas has developed simultaneously; only the weight of evidence necessary to prove fraud differs. Questions regarding the safeguards provided the taxpayer when the net worth method is used arise frequently. Although many of these questions have been answered, others have not. It is the proper time for this Court to again evaluate this potentially dangerous proof of guilt.

Finally, and ironically, the least important matter for purposes of this Petition requesting a Writ of Certiorari is the request of an individual taxpayer for a full and fair hearing concerning the accusation that he fraudulently attempted to evade his tax liability. The taxpayer attempted at trial to prove to the Tax Court in the only manner he had available that the deficiency allegation of the government was erroneous. Circumstantial evidence presented by the government was weighed, carefully analyzed and approved. Circumstantial evidence offered by the taxpayer was ignored. Simple principles of justice require that when the burden of proof is placed upon a party, he is owed at a minimum a finding on his evidence.

CONCLUSION

For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Third Circuit.

Respectfully submitted,

By

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Date: September 11, 1979

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 78-2433

HARRY HARPER WAGNER and
RUTH N. WAGNER,
Appellants
v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the Decision of the
United States Tax Court Entered July 3, 1978
Docket No. 260-74

Argued June 7, 1979
Before: ADAMS and ROSENN, Circuit Judges,
and LACEY, District Judge.*

JUDGMENT ORDER

After consideration of all contentions
raised by appellants, it is

ADJUDGED AND ORDERED that the decision of
the Tax Court, explained in a comprehensive
opinion reported at 37 T.C.M. (CCH) 254 (1978), be
and is hereby affirmed.

Each side to bear its own costs.

ATTEST: BY THE COURT,

/S/ Thomas Quinn /S/ Judge Adams
Thomas F. Quinn, Circuit Judge
Clerk

DATED: June 13, 1979

*Honorable Frederick B. Lacey, United States
District Court for the District of New Jersey,
sitting by designation.

T. C. Memo. 1978-49

UNITED STATES TAX COURT

HARRY HARPER WAGNER and RUTH N. WAGNER,
Petitioners v. COMMISSIONER OF
INTERNAL REVENUE, Respondent

Docket No. 260-74 Filed January 31, 1978

Arthur L. Berger and John S. Oyler,
for the petitioners.

Alan E. Cobb, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined
deficiencies in petitioners' Federal income
tax and additions to tax as follows:

<u>Year</u>	<u>Deficiency</u>	<u>Additions to the Tax</u>	
		<u>Sec. 6653(b)</u>	<u>Sec. 6654</u>
1959	\$25,335.80	\$12,667.90	--
1960	56,420.36	28,210.18	--
1961	26,577.61	13,934.39	--
1962	2,651.56	1,359.22	--
1963	1,539.32	769.66	7.83
1964	17,427.05	8,713.53	13.12
1965	39,073.99	19,537.00	--
1966	40,874.53	20,437.27	--
1967	2,709.22	1,354.61	--
1968	540.02	270.01	--
1969	37,100.36	18,550.18	--
1970	13,290.61	6,645.31	--

The issues remaining for decision are (1) whether petitioners understated their taxable income for the years 1959 through 1966, and (2) whether, if petitioners did underestimate their taxable income for this period, such understatemt was due to fraud. Absent a finding of fraud, assessment of a deficiency for the years 1959 through 1966 would be barred by the statute of limitations. Respondent has conceded on brief that petitioners are not liable for the deficiencies in tax or additions to tax under section 6653(b)^{1/} for the taxable years 1967 through 1970.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

^{1/} All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise stated.

Petitioners Harry Harper Wagner, and Ruth N. Wagner, husband and wife, resided in Hershey, Pennsylvania, at the time their petition was filed herein. Petitioner Harry Harper Wagner filed separate individual income tax returns for the years 1959 and 1960 with the office of the Internal Revenue Service in Philadelphia, Pennsylvania. Petitioners filed joint income tax returns for the years 1961 through 1970 with the same office. Petitioners' income tax returns were prepared on the cash basis with inventories.^{2/}

During the years in issue, petitioner operated a retail grocery store in Hershey, Pennsylvania. Petitioner began in the grocery business in 1938, when he joined his father in an equal partnership. Their business consisted of a meat and grocery store and a meat peddling route. After his father's death on October 17, 1946, petitioner became sole owner of the business. The meat peddling route was discontinued after 1961.

Petitioner put the following earnings into Government bonds during World War II.

<u>Date Issued</u>	<u>Denomination</u>	<u>Number</u>	<u>Cost</u>
April 1942	\$ 500	2	\$ 750
April 1942	100	20	1,500
June 1942	100	20	1,500
			<u>\$ 3,750</u>

^{2/} Since Ruth N. Wagner is a party to this proceeding solely by reason of filing a joint return, Harry H. Wagner will be referred to as petitioner.

<u>Date Issued</u>	<u>Denomination</u>	<u>Number</u>	<u>Cost</u>
June 1944	\$ 100	4	\$ 300
October 1944	1,000	1	750
November 1944	1,000	3	2,250
			<u>\$ 3,300</u>

Petitioner paid the following income taxes during the following years prior to 1959:

<u>Year</u>	<u>Income Tax Paid</u>
1946	\$ 199.00
1947	762.98
1949	347.80
1950	1,434.74
1951	981.26
1952	2,347.94
1954	345.36
1956	378.81

Petitioner received the following income tax refunds for the years 1948, 1957, and 1958:

<u>Year</u>	<u>Refund of Tax and Interest</u>
1948	(Unknown)
1957	\$ 565.83
1958	689.22

In 1960, petitioner constructed a new store with 12,000 square feet of space, at a cost of \$58,605.88, which he opened for business in May 1961. During 1961 he purchased equipment and fixtures for the new store at a total cost of \$57,396.08. In addition, petitioner increased his inventory from \$15,831.14 at the end of 1960 to \$38,470.61 at the end of 1961, an increase of \$22,639.47, making his total investment in the new store \$138,641.43. When he stocked his new

store with merchandise in May 1961, petitioner receiver \$23,000 in credit from the Harrisburg Grocery Store. Petitioner paid off his credit balance of \$18,183.15 by check on December 5, 1961.

The new store is bigger than some supermarkets. It has three checkout counters with three cash registers and six meat scales. Nevertheless, generally only one checkout counter and one cash register were in use. The store operates more as a meat market and convenience store than as a supermarket. Petitioner's only employees in the store were his wife, son, and brother. On occasion, his sister and brother-in-law would help out.

A considerable portion of petitioner's business was attributable to the sale of meats. As a licensed butcher, petitioner was able to buy cattle locally and slaughter them himself.³ In addition to the sale of meat at his grocery

3. Petitioner's total cattle purchases per records, and petitioner's total purchases per his tax returns, were during the years 1959 through 1966, as follows:

<u>Year</u>	<u>Total Cattle Purchases Per</u>	<u>Total Purchases</u>
	<u>Ledger Books</u>	<u>Per Tax Returns</u>
1959	\$ 34,616.41	\$ 194,886.45
1960	33,374.24	177,523.49
1961	31,439.59	224,319.51
1962	37,582.78	222,236.00
1963	35,487.67	233,107.85
1964	35,331.48	242,890.70
1965	38,168.44	254,440.23
1966	39,668.48	247,168.58

store, petitioner peddled meat in the surrounding community. Petitioner delivered the meat to his customers in refrigerated trucks. After the opening of his new store in 1961, petitioner discontinued his meat peddling routes. He did, however, continue to make deliveries of meat through the years in issue on the basis of orders called into the store. Petitioner's records reflect substantial gasoline purchases for the years 1959 through 1966.

Petitioner established and maintained his own single entry bookkeeping system. Petitioner's wife handled the cash register at the store. At the end of each day, she entered the expenses paid in cash during the day from the cash register. The cash, plus the expenses paid out, represented the day's total receipts. Petitioner added the daily receipts and recorded the monthly totals in his ledger book. His business expenses were recorded in the book on a daily basis.

Petitioner dealt almost entirely in cash during the years at issue. His business purchases were made largely in cash, and he accumulated his business income in cash, depositing cash not needed for current operations either at the end of the year or more frequently. When he did use checks, it was his practice to bring the cash to the bank and write a check on it. As a result of his frequent use of cash, he deposited and withdrew substantial sums of money from the bank.

In addition to these transactions, it was his common practice to purchase and redeem certificates of deposit, and to a lesser extent United States Savings Bonds. Beginning in 1965, petitioner became a frequent trader in stocks. In 1964, he held stock costing him \$5,100. By 1966, he had stocks and securities with a cost

basis of \$197,076.23. Despite the brisk activity in petitioner's brokerage account, he continued to conduct his stock transactions from a cash fund. When petitioner purchased stock, he did so by depositing cash in a checking account and drawing a check for the amount of the purchase. When petitioner sold stock he cashed the checks which he received in payment.

Petitioner was known to carry large sums of money on his person on occasion, and had a special fondness for one thousand dollar bills.^{4/} Despite this apparent display of wealth, petitioner lived very frugally. He lived in a modest home, took no vacations, and apart from his plunge into the stock market, demonstrated no expensive habits.

Following is a summary of petitioner's assets, liabilities and reserves, as constructed by respondent, for the period 1958 through 1970:

4. On one occasion in 1963, petitioner withdrew \$50,000 in \$1,000 bills from a savings account at the Hershey National Bank in Hershey, Pennsylvania.

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<u>Assets</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
Cash-on-Hand	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00
Cash-in-Bank	120,525.67	168,427.94	184,403.29	190,216.86	208,044.91	178,806.34
U.S. Savings Bonds-Series E	67,687.50	52,687.50	61,687.50	32,137.50	- 0 -	- 0 -
Receivable from Stock Broker	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
Stock	- 0 -	5,100.00	5,100.00	5,100.00	5,100.00	5,100.00
Face Value of Coins in Safe Deposit Box	803.91	803.91	803.91	803.91	803.91	803.91
Personal Auto's	5,937.80	6,837.80	10,837.80	8,608.60	8,608.60	9,414.13
Business Assets:						
Inventory	5,907.45	12,060.56	15,831.14	38,470.61	35,090.48	29,148.23
Depreciable Assets	47,045.07	51,125.71	98,700.49	162,860.92	165,131.12	159,174.94
Rental Property:						
226 E. Derry Rd.	6,325.00	6,325.00	6,325.00	6,325.00	6,325.00	6,325.00

	Residence: 303 E. Derry Rd. 5,000.00					
Unidentified Asset Expenditure	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
TOTAL ASSETS YEAR END	<u>\$263.632.40</u>	<u>311.868.42</u>	<u>392.189.13</u>	<u>453.053.40</u>	<u>471.907.76</u>	<u>481.576.29</u>

Liabilities

Hummelstown National Bank	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
R. T. Randall and Company	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -

Reserve for Depreciation:

Rental Property	1,400.00	1,500.00	1,600.00	1,700.00	1,800.00	1,900.00
Business Assets	<u>13,717.21</u>	<u>17,568.91</u>	<u>20,113.52</u>	<u>30,656.16</u>	<u>42,967.65</u>	<u>47,492.88</u>
TOTAL LIAB. & RESERVES	<u>\$ 15,117.21</u>	<u>19,068.91</u>	<u>21,713.52</u>	<u>32,356.16</u>	<u>44,767.65</u>	<u>49,392.88</u>

5. Cash in bank consists of cash on deposit in checking accounts, savings accounts and certificates of deposit.

Rental Property:
226 E. Derry Rd. 6,325.00 6,325.00 - 0 - - 0 - -

Assess	159,174.94	159,465.66	164,498.16	150,252.35	150,252.35	153,275.23	155,231.23
Depreciable							

Rental Property:	226 E. Derry Rd. 6,325.00	6,325.00 - 0 - - 0 - -	- 0 - - 0 - -
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Assess	155,250.00	153,275.16	58,375.00	52,537.16	52,537.16	58,375.00	59,250.00
Depreciable							

Assess	159,174.94	159,465.66	164,498.16	150,252.35	150,252.35	153,275.23	155,231.23
Depreciable							

Rental Property:	226 E. Derry Rd. 6,325.00	6,325.00 - 0 - - 0 - -	- 0 - - 0 - -
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Assets	1964	1965	1966	1967	1968	1969	1970
Cash-on-Hand	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00
Cash-in-Bank	228,821.47	271,213.85	194,676.54	123,940.63	31,171.84	34,005.11	46,459.69
U.S. Savings Bonds-Series E	- 0 -	- 0 -	2,943.75	- 0 -	14,006.25	- 0 -	- 0 -
Receivable from Stock Broker	- 0 -	- 0 -	14,583.44	- 0 -	- 0 -	- 0 -	- 0 -
Stock	5,100.00	30,717.13	197,076.23	261,427.78	253,686.29	361,255.34	396,415.75
Face Value of Coins in Safe Deposit Box	803.91	803.91	803.91	803.91	803.91	803.91	803.91
Personal Auto's	9,414.13	9,414.13	4,000.00	4,000.00	5,890.00	5,890.00	5,890.00
Business Assets:							
Inventory	29,429.50	52,232.78	53,591.75	52,947.62	52,537.16	58,375.00	59,250.00

In re: Harry H. and Ruth N. Wagner
Docket No. 260-74

Residence:	303 E. Derry Rd. 5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00
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Unidentified Asset Expendediture	84,303.74	84,303.74	84,303.74	174,849.71	278,351.16	278,351.16	278,351.16
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TOTAL ASSETS YEAR END	<u>\$ 531,872.69</u>	<u>622,976.20</u>	<u>724,977.52</u>	<u>776,722.00</u>	<u>795,198.96</u>	<u>900,455.75</u>	<u>950,961.74</u>
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Liabilities

Hummelstown National Bank	- 0 -	- 0 -	2,070.00	47,890.64	27,092.01	57,369.08	57,369.08
R. T. Randall and Company	- 0 -	- 0 -	990.00	- 0 -	- 0 -	- 0 -	- 0 -

Reserve for Depreciation:

Rental Property	2,000.00	2,100.00	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
Business Assets	<u>56,267.62</u>	<u>63,469.42</u>	<u>70,263.78</u>	<u>68,176.99</u>	<u>74,333.09</u>	<u>80,048.62</u>	<u>85,490.01</u>
TOTAL LIAB. & RESERVES	<u>\$ 58,267.62</u>	<u>65,569.42</u>	<u>73,323.78</u>	<u>116,067.62</u>	<u>101,425.10</u>	<u>137,417.00</u>	<u>142,859.03</u>

5. Cash in bank consists of cash on deposit in checking accounts, savings accounts and certificates of deposit.

The parties agree with the figures set forth in the summary except for the cash on hand, inventories^{6/} for 1965 and subsequent years, and "unidentified asset expenditures."

Respondent originally contended that the cash on hand was \$3,500, although on brief he also argues that even if there was a substantial cash hoard, it was the same at the beginning of 1959 and 1967. Petitioner argues that he had an opening cash hoard of \$124,000.^{7/} We find that

6. The controversy over inventories was the result of a compensating entry made by petitioner in reporting his sales in 1965. As previously noted, petitioner's wife kept a daily receipts record consisting of two columns. In the first column she recorded the amount of cash in the cash register at the end of the day. When petitioner recorded the monthly totals from his daily receipts record in his ledger book for the year 1965, he recorded only the monthly totals of the first column. Thus, he understated his cash receipts recorded in his daily receipts record by the total of the second column, \$31,170.20.

When computing his taxable income from his books and records for 1965, petitioner realized that his income as computed was incorrect, given the substantial cash petitioner had accumulated and had on hand at the end of the year. In trying to correct this disparity, petitioner raised his inventory for the year end by \$22,793.28, thereby increasing his taxable income for the year. Petitioner's inventory has thus been inflated by this amount every year since 1965.

7. Petitioner contends that he received \$30,000 from each of his parents as a gift, that he accumulated \$39,000 from yearly savings of \$3,000 each and that he had \$25,000 from pre-World War II accumulations, a total of \$124,000.

petitioner's cash on hand at the beginning of the period here in question was no more than \$3,500.

Respondent contends that petitioner used the following funds for unidentified assets and/or expenditures:^{8/}

- (a) \$11,514 petitioner received on the redemption of U.S. Savings Bonds, Series E on April 10, 1962.
- (b) \$22,789.74 petitioner received on the redemption of U.S. Savings Bonds, Series E on April 19, 1962.
- (c) \$50,000 petitioner withdrew in \$1,000 dollar bills from a joint savings account number 1572, at the Hershey National Bank on June 4, 1963.

8. Respondent originally contended that in addition to the above, cash from the following sources were also used for unidentified assets and/or expenditures:

1967	Source	Cash Received
May 10	600 shares of Harsco Corp.	\$ 13,589.72
June 12	Hummelstown National Bank-Certificate of Deposit No. 386	54,600.00
July 17	U.S. Savings Bonds, Series E	6,412.50
August 7	Hershey National Bank Savings Account No. 11040	13,000.00
Dec. 26	U.S. Savings Bonds, Series E	2,943.75
	TOTAL	<u>\$ 90,545.97</u>

(continued).

Respondent computed petitioner's understatement of income as follows:

(continued)

<u>1968</u>	<u>Source</u>	<u>Cash Received</u>
Feb. 5	Farmer's Bank & Trust Co.-Certificate of Deposit No. 22609	\$ 20,000.00
June 4	200 shares of Hershey Foods	6,120.87
June 12	200 shares of Hershey Foods	6,120.87
June 13	400 shares of Hershey Foods	12,838.72
Nov. 8	300 shares of Bethlehem Steel	9,740.97
Dec. 2	600 shares of Hershey Foods	19,407.32
Dec. 2	500 shares of Hershey Foods	16,234.97
Dec. 3	400 shares of Hershey Foods	\$ 13,037.73
	TOTAL	<u>\$103,501.45</u>

As noted, however, respondent has now conceded the years after 1966.

In re: Harry H. and Ruth N. Wagner
Docket No. 260-74

Description	1958	1959	1960	1961	1962
TOTAL ASSETS	\$263,632.40	\$311,868.42	\$392,189.13	\$453,053.40	\$471,907.76
Liabilities					
Reserve for Depr.	15,117.21	19,068.91	21,713.52	32,356.16	44,767.65
NET WORTH	248,515.19	292,799.51	370,475.61	420,697.24	427,140.11
Net Worth Beginning of Year	<u>248,515.19</u>	<u>292,799.51</u>	<u>370,475.61</u>	<u>420,697.24</u>	
Increase in Net Worth	44,284.32	77,676.10	50,221.63	6,442.87	
ASSESSMENTS:					
Deductions: Income Tax Payments	1,710.78	2,032.49	2,108.25	2,136.38	
Personal Ins. Premiums	2,081.20	7,508.00	7,499.50	7,239.30	
Personal Expenses - Living	3,000.00	3,000.00	3,000.00	3,000.00	

Personal Expense - Other	1,820.00	1,820.00	1,820.00	1,020.00
Non-Deductible Loss - Personal Autos			3,594.70	
Deductions: Dividend Exclusion	(100.00)	(100.00)	(100.00)	(100.00)
Non-Taxable Portion - Capital Gains				
NET ADJUSTMENTS:	8,511.98	14,261.29	17,922.45	14,095.68
ADJUSTED GROSS INCOME AS CORRECTED	52,796.50	91,937.39	68,144.08	20,538.55
DEDUCTIONS:				
Standard or Itemized Ded.	(500.00)	(500.00)	(1,000.00)	(1,000.00)
Exemptions	<u>(1,800.00)</u>	<u>(1,800.00)</u>	<u>(1,800.00)</u>	<u>(1,800.00)</u>
TAXABLE INCOME AS CORRECTED	50,496.30	89,637.39	65,344.08	17,738.58
TAXABLE INCOME PER RETURN	8,667.81	8,816.34	14,358.47	8,214.67
RESTATEMENT OF TAXABLE INCOME	\$ 41,828.49	50,821.05	50,985.61	9,520.00

In re: Harry H. and Ruth N. Wagner Booklet No. 260-74			
Description	1963	1964	1965
TOTAL ASSETS	\$481,576.29	\$531,872.69	\$622,976.20
Liabilities			
& Reserve for Depr.	<u>49,392.88</u>	<u>58,267.62</u>	<u>65,569.42</u>
			<u>73,323.78</u>
NET WORTH	432.183.41	473,605.07	557,406.78
Net Worth Beginning of Year	427,140.11	432,183.41	473,605.07
Increase in Net Worth	5,043.30	41,421.66	83,801.71
			94,246.96
ASSESSMENTS:			
Deductions: Income Tax Payments	2,945.17	3,136.88	3,625.63
Personal Ins. Premiums	7,162.05	7,083.40	6,889.85
Personal Expenses - Living	3,138.29	3,328.29	3,138.29

NON-Deductible Loss - Personal Autos			
	2,040.45		1,914.13
Deductions:			
Dividend Exclusion	(100.00)	(200.00)	(200.00)
Non-Taxable Portion - Capital Gains	<u>(1,887.75)</u>		<u>(4,158.25)</u>
NET ADJUSTMENTS:	<u>15,731.28</u>	<u>15,688.57</u>	<u>15,793.77</u>
ADJUSTED GROSS INCOME AS CORRECTED	20,774.58	57,110.23	99,595.48
DEDUCTIONS:			
Standard or Itemized Ded.	(1,000.00)	(1,000.00)	(1,000.00)
Exemptions	<u>(1,000.00)</u>	<u>(1,000.00)</u>	<u>(1,000.00)</u>
TAXABLE INCOME AS CORRECTED	17,974.58	54,310.23	96,795.48
TAXABLE INCOME PER RETURN	12,540.61	14,394.18	19,677.72
RESTATEMENT OF TAXABLE INCOME	5,433.97	39,916.05	77,117.76
			77,249.18

OPINION

Respondent has determined petitioner's income for the years in issue utilizing the net worth and expenditures theory. In using the net worth method, respondent first attempts to establish the taxpayer's net worth at the beginning of a given year. He then computes increases in the taxpayer's net worth in each succeeding year under examination, calculating the difference in the taxpayer's net worth at the beginning and the end of each year. To these increases certain adjustments are made including the addition of non-deductible expenditures, such as living expenses. If the total increases in net worth are substantially greater than the taxable income as reported by the taxpayer, respondent claims the excess is unreported taxable income, unless it can be traced to a nontaxable source (such as a cash hoard, gifts, inheritances, etc.).

The parties agree on all of the elements entering the net worth calculation except for cash on hand, inventory for 1965 and 1966, and an item used in respondent's computations entitled "unidentified asset expenditure."

At the outset, we note that any assessment for the years in issue is barred by the statute of limitations unless respondent can show petitioner filed a false or fraudulent return with intent to evade tax. Section 6501(c)(1). In Ross Glove Co. v. Commissioner, 60 T.C. 569, 608 (1973), we approved the following definition of fraud:

The term "fraud" means actual intentional wrongdoing, and the intent required is the specific purpose to

evoke a tax believed to be owing. Fraud implies bad faith, intentional wrongdoing, and a sinister motive. It is never imputed or presumed and the courts will not sustain findings of fraud upon circumstances which at the most create only suspicion.***[Citation omitted].

Respondent has the burden of proving fraud by clear and convincing evidence. Section 7454(a); Rule 142(b) Tax Court Rules of Practice and Procedure. Beaver v. Commissioner, 55 T.C. 85, 92 (1970). The existence of fraud is a factual question which must be resolved by reference to all the evidence in the record. See Otsuki v. Commissioner, 53 T.C. 96, 105-106 (1969).

In making our analysis it would be convenient to focus on two periods--1959 through 1961 and 1962 through 1966. In the earlier period, respondent confined himself to a more or less conventional analysis of the taxpayer's net worth, and the dispute turns on the amount of any beginning cash hoard. For the years 1962-1966, however, respondent added to petitioner's net worth a sum represented by "unidentified asset expenditures."

We begin by focusing on the later years--1962-1966. The centerpiece of the respondent's case for these years is his assertion that petitioner used current income to either amass a large hoard of funds or make large non-deductible expenditures, which although not discoverable, should be included in determining his increase in net worth.

Specifically, respondent contends that the following funds were used for unidentified assets and/or expenditures:

- (a) \$11,514 petitioner received on the redemption of U.S. Savings Bonds, Series E on April 10, 1962.
- (b) \$22,789.74 petitioner received on the redemption of U.S. Savings Bonds, Series E on April 19, 1962.
- (c) \$50,000 petitioner withdrew in \$1,000 dollar bills from a joint savings account, account number 1572, at the Hershey National Bank on June 4, 1963.

In essence, respondent argues that since he was unable to trace these funds, they must have been used in some fashion, either to acquire some unknown asset or to make some undiscovered and nondeductible expenditure.

Respondent's case for 1962 to 1966 depends almost wholly on his use of this "unidentified asset expenditures" account. While in a particular case, this methodology may have merit, it is inappropriate in the case before us. The addition of sums to the unidentified asset expenditures category totally ignored the manner in which petitioner handled his financial affairs. Petitioner conducted his business transactions through the use of what was essentially a revolving cash fund. During the years in issue, petitioner engaged in literally thousands of transactions. Sometimes the funds from the sale of stock or the redemption of certificates of deposit were immediately reapplied to purchase other assets, sometimes they were not. Moreover, when some other asset was purchased, it was highly unlikely that the cost of that asset would correspond to the exact dollar amount of the sum previously added to the cash fund.

The methodology respondent used for tracing was limited both in duration and amount. While it is not entirely clear, funds were generally not traced beyond an arbitrary cut-off period of seven days nor were amounts of less than \$5,000 traced. The major defect inhering in this procedure is the danger of duplication. Given the short turnover period the respondent allowed (seven days), and the rather high amounts required to warrant any tracing (\$5,000), this is a very significant defect and a substantial danger. For example, assume a bond was redeemed and the cash from that redemption went back into a cash fund. If nothing was purchased from the fund within seven days, or the funds were reinvested in amounts of from \$5,000 to \$6,000, or some combination of the two, respondent would conclude that the funds from the redemption went into an unidentified asset expenditure. Yet if stock was purchased from the fund beyond the tracing period, in amounts below the tracing criteria, or some combination of the two, respondent would also include the stock as part of the taxpayer's net worth.

After careful study of the record, we believe that example is typical of what often happened here, and respondent's agent, on cross-examination, admitted some probable instances of duplication when confronted with certain specific examples. Some of these admittedly related to the years 1967 through 1970, which respondent has now conceded. However, we feel no more comfortable with the same theory in the earlier years that respondent has discarded in the later years. Respondent noted on brief that petitioner's argument that large sums charged to the "unidentified asset expenditure" account for 1967 and 1968 were ultimately invested in the stock market and then said "based on the record in this case, this is a plausible [sic] explanation." We

believe this explanation to be no less plausible for 1962 to 1966.

In fact, it is even more likely that the funds designated as unidentified asset expenditures for the years 1962 through 1966, were ultimately reinvested in visible assets (e.g., stock) than the funds for the years conceded by respondent. In the 1967 through 1970 period, stock market investments increased by \$134,987.97, from \$261,427.78 to \$396,415.75. At the same time, cash in bank went down from \$194,676.54 to \$46,459.69, a difference of \$148,216.85, and bank loans increased from \$2,070 to \$57,369.08, a difference of \$55,299.08, both of these representing obvious visible sources for the stock market investments.

By contrast, in the 1962 through 1966 period, stock market investments increased by \$191,976.23, from \$5,100, to \$197,076.23. In the same period, cash in the bank actually increased from \$190,216.86 to \$194,676.54. Comparing the two periods 1962 to 1966 with 1967 to 1970, stock market investments increased by more during the 1962 through 1966 period, while uses of visible sources for the stock market investments were actually much greater in the later period than they were in the earlier period.

In sum, we believe that the method used by respondent in determining petitioner's net worth was not particularly well conceived and failed to take into account the rather extraordinary nature of the individual taxpayer.

We recognize that the large cash withdrawals are likely, when considered in the total circumstances of this case, to create strong suspicions of fraud. It is undisputed that petitioner

withdrew \$50,000 in \$1,000 bills from Hershey National Bank on June 4, 1963. He told several inconsistent stories about how he used these funds, or "might" have used them, in the final analysis relying heavily on a lapse of memory. We are skeptical that he would be unable to recall what he did with such a large sum of money. In many other instances it was extremely difficult to tell when petitioner's testimony was truthful or mendacious. He often equivocated, sometimes he was understandably unable to reconstruct events occurring a decade and a half ago, and on other occasions we strongly suspect he deliberately fabricated his testimony, often on an ad hoc basis.

Nevertheless, petitioner was a suspicious man, who became increasingly distrustful of respondent's agents, which undoubtedly explains some of the equivocation. While the issue in these years is hardly free from doubt, we are ultimately persuaded that the defects in the centerpiece of respondent's case--the "unidentified asset expenditures" line of the net worth statement--prevent respondent from carrying his burden of proving fraud by clear and convincing evidence. Congress did not say that when sloppy books and records exist, or when there has been extensive use of cash, or when other circumstances creating strong suspicions of fraud exist, that the statute may be opened up. Rather it is well-settled that fraud must be proven by "clear and convincing evidence." Rule 142(b), Tax Court Rules of Practice and Procedure; Beaver v. Commission, 55 T.C. 85, 92 (1970). Obviously, this language provides qualitative rather than quantitative criteria, and is not amenable to mathematical certainty. Necessarily, when a record is as confused as this one, encompassing in the earliest year a period that occurred

nearly two decades ago, there will be some doubt and uncertainty about the conclusion reached in the light of the Congressionally-mandated criteria. This is the nature of the process, and while we believe the conclusion to be much closer than petitioner concedes, we nevertheless hold that respondent has failed to sustain his burden of proof in the years 1962 to 1966.

The years 1959-1961 are an entirely different matter, since respondent's calculations do not involve a line for "unidentified asset expenditures." Standard net worth plus expenditures techniques were used for these years, and as petitioner noted on brief, in these years "the crux of the dispute is the existence of a beginning cash hoard." Or, as petitioner put it in his opening statement, "for the earlier years, the result will pretty much depend upon the Court's judgment as to the petitioner's allegation of opening cash."

The petitioner claims a cash hoard of \$124,000 at the end of calendar year 1958. Respondent contends opening cash on hand was \$3,500. We find petitioner's claim preposterous and therefore sustain respondent on this point. We begin by noting that petitioner told so many inconsistent stories concerning his cash hoard over such an extended period of time that the search for the truth has proved elusive in the extreme. In 1967, petitioner initially stated that he had received a substantial inheritance from his father and gifts from his mother. Based on his father's will, which was introduced into evidence; on statements made by petitioner (and corroborated by Mrs. Wagner) regarding the circumstances and conduct of petitioner's parents; and based on petitioner's testimony on the subject, which we found wholly unreliable on this

point, we do not believe that he received any money from his parents.^{9/}

Additionally, petitioner on several occasions also told respondent's agent that he "did not hoard money" and pretty much conceded he did not have any large cash hoard. Referring to large cash amounts he told these agents that "I would never keep money like that around."

Prior to the present trial petitioner stated on several occasions that he kept on hand cash accumulated during the current year, but always deposited it at the end of the year. At one point, petitioner told respondent's agents that he deposited his receipts at years' end never retaining any more than \$3,500 for bills beginning the following year. This story was corroborated by statements made by Mrs. Wagner.^{10/} At the trial several tin boxes were produced and a

^{9/} That is, other than small incidental gifts and possibly the \$1,000 specific bequest each child was to receive under the will of petitioner's father. We note that although petitioner operated the business with his father, he was required to purchase his father's share at the latter's death. We also note that he made several statements to respondent's agents that, if not flatly contradicting the claim of substantial inheritances and/or gifts, are inconsistent with such a claim.

^{10/} Mrs. Wagner did not testify at the trial, but an interview she gave to respondent's agent was stipulated. One cannot read the interview without being impressed by her candor and integrity. She clearly found the notion of a large cash hoard virtually impossible to believe.
(continued)

virtually incomprehensible story told concerning the sequential transfer of cash from one box to another at various periods. A good deal of the story appeared to be created from whole cloth on an ad hoc basis, with emendations invented on the spot to cover weak points as they appeared.

The final resting place of the huge cash hoard petitioner claims (some of which filtered its way through the series of tin boxes) was some cigar boxes resting in a hope chest in petitioner's attic. It is beyond belief that petitioner laid up this treasure "where moth and rust doth corrupt and where thieves break through and steal." Not to mention the danger of fire. The record is clear that Mrs. Wagner was unaware of any large cash hoard to be removed in case of fire.^{11/}

In addition to the extreme improbability that petitioner would expose such a large principal amount to loss, it is difficult to believe that he would forego the substantial interest that a safe lodging of this money with the bank would provide. As for petitioner's claimed lack

(continued).

However, while we find her statements consistent without conclusion, we do not place great reliance on them, since her familiarity with the business and family financial affairs was quite clearly limited, being based primarily on her role in operating the check-out counter.

^{11/} A picture taken the Sunday before the trial shows the chest and cigar boxes in the attic of petitioner's frame home where these huge sums were allegedly kept. We would find it easier to believe in the abominable snowman than to believe petitioner's story on this point.

of confidence in banks, we note that he made substantial use of them throughout the period in question, it being stipulated that he had as much as \$271,213.85 in banks in 1965.

It is undisputed that petitioner did on occasion carry around substantial numbers of \$1,000 bills. But we suspect that as soon as this display reaped its psychological reward, petitioner reinvested the large bills in a safe place calculated to yield a reasonable return.^{12/} We do not, therefore believe that the mere ostentatious display of \$1,000 bills on a few isolated occasions establishes a cash hoard at the beginning of 1959 in spite of the overwhelming evidence that none existed.

We acknowledge that we are not entirely comfortable in reaching different conclusions with regard to the early and later years. However, the Court must decide the case on the record made, and as to the later years respondent simply failed to sustain his heavy burden of proof. Additionally, we note that petitioner discontinued his meat peddling business after 1961.^{13/} This loss of income and smaller than

^{12/} Indeed, throughout all of the later years, we recognized that this probably occurred.

^{13/} Respondent contends that petitioner conducted the meat peddling route through 1966. However, the returns before us demonstrate that the last year petitioner took a deduction for a meat peddling license was in 1961. The disappearance of this item from his return, prior to his difficulties with the Internal Revenue Service, leads us to believe petitioner's assertion that he discontinued the meat peddling route at this time.

expected volume in the new store may justify this divergence, at least in part.

Respondent attempted to salvage all of the years through 1966 with an argument based on two items from the record relating to petitioner's alleged cash hoard. The first of these items is a scrap of paper, on which petitioner wrote down some figures, apparently arriving at \$173,000 as his cash hoard sometime in 1966. The second item was the following testimony of petitioner from the trial:

Well, sometimes the money went into that chest, but there--here I was--after '66, I started using money to--I didn't start using that money, I believe, until '67 or '68, when I run out of money in the savings accounts, then I started buying and paying for them stocks--around '67 or--I'm not sure. It happened after '65 when I started playing the stock market.

The slip of paper records a summary of fabrications recorded and then made available to respondent very late in the sequence of events before us. Respondent argues that assuming the cash hoard was in existence, petitioner's testimony indicates it remained intact through 1966. As recounted earlier, respondent's case for 1962-1966 suffers from deficiencies in his theory of unidentified asset expenditures as applied to this case. However, we do not believe that his attempt to salvage these years by circumventing these deficiencies with an alternative theory concedes the existence of an opening cash hoard at the beginning of 1959.

We reject respondent's attempt to breathe new life into the years 1962-1966 by focusing on petitioner's final prevarication regarding a cash hoard. Conversely, we do not believe that by arguing for certain consequences assuming the truth of petitioner's statement as to the use of his claimed cash hoard, respondent concedes the existence of such a hoard. Respondent's entire case was predicated on the absence of any large hoard and on this point we find his case virtually unassailable.^{14/} We therefore sustain respondent's determination for the years 1959-1961.

Decision will be entered
under Rule 155.

^{14/} During the trial, petitioner argued that his books and records were of the garden variety expected of a small business and sufficiently accurate to preclude reconstruction of income by the net worth method. We disagree completely. Among many factors we might point to, the books improperly recorded cattle purchases and inventory was deliberately understated as a compensating error. Petitioner stated he put his interest in with his business income in the early years, and this is not true. Additionally, we do not believe the books properly reflected his income from the meat peddling route.

No. 79-407

Supreme Court, U.S.
FILED

OCT 26 1979

ROTHAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1979

HARRY HARPER WAGNER AND
RUTH N. WAGNER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE THIRD CIRCUIT*

MEMORANDUM FOR THE RESPONDENT
IN OPPOSITION

WADE H. McCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States
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**MEMORANDUM FOR THE RESPONDENT
IN OPPOSITION**

Petitioner¹ seeks review of the decision below in this income tax case holding that documented evidence establishing increases in his net worth during 1959-1961 represented unreported taxable income and not expenditures from a preexisting cash hoard.

The pertinent facts may be summarized as follows: During the taxable years at issue, petitioner was a butcher and grocer who bought and slaughtered cattle (Pet. App. 6a-7a; R. 302, 308).² Petitioner sold the meat

¹"Petitioner" refers to Harry Harper Wagner. Ruth Wagner is a party solely because she filed joint returns with her husband for the years at issue.

²"R." refers to the separately bound record appendix filed in the court of appeals.

through his store and through a meat peddling route that utilized several refrigerated trucks. These activities often required petitioner to work until midnight (R. 759-762, 825, 834, 918-920). Petitioner's defense to deficiencies in income tax determined by the Commissioner by means of the net worth method was that the government's computation did not include in cash-on-hand a large cash hoard that he kept in his attic. The Tax Court observed that prior to trial, petitioner denied the existence of any cash hoard (Pet. App. 27a). After characterizing the evidence that no such cash hoard existed as "overwhelming" the Tax Court rejected petitioner's claim as "preposterous" (Pet. App. 26a, 29a).

Petitioner argues (Pet. 7-10) that the evidence regarding the profitability of his grocery business indirectly established the existence of a cash hoard. But there is no necessary correlation between the success of petitioner's grocery and the existence of a cash hoard. At all events, the weight to be given particular evidence of a cash hoard is peculiarly within the province of the trier of fact, and the Tax Court's rejection of petitioner's factual claim is amply supported by the evidence.

Petitioner also contends (Pet. 9) that he "introduced evidence demonstrating * * * [that his] sole source of income could not [have] generate[d] the alleged deficiency." But petitioner's only evidence on this point was the testimony of Stanley Steiner, petitioner's accountant, whose testimony was based largely on figures derived from petitioner's own books and records which the Tax Court determined did not adequately reflect his income (Pet. App. 31a). Moreover, Steiner's calculations failed to take into account the income generated by petitioner's meat business (R. 1037). The Tax Court therefore properly declined to attach any weight to Steiner's testimony (R. 1053, 1159).

2. Contrary to petitioner's further claim (Pet. 7-8) the government need not establish a likely source of unreported income in a net worth case if the government negates all possible sources of nontaxable income. *United States v. Massei*, 355 U.S. 595 (1958). Accord: *United States v. Costanzo*, 581 F. 2d 28 (2d Cir. 1978), cert. denied, No. 78-394 (Jan. 8, 1979); *Foster v. Commissioner*, 487 F. 2d 902 (6th Cir. 1973); *Gatling v. Commissioner*, 286 F. 2d 139 (4th Cir. 1961). Here, petitioner conceded that he had no substantial sources of nontaxable income during the years 1959 through 1961.³ Thus, there was no requirement that the government establish a likely source for petitioner's unreported income in addition to negating his cash hoard claim, nor was the government obliged to refute petitioner's evidence on the profitability of his grocery store operation. The issue in this case was not whether petitioner failed to report income from his grocery store, but whether the increases in his net worth during the years 1959 through 1961 evidenced unreported taxable income.

The cases upon which petitioner (Pet. 9-10) relies do not conflict with the decision below. In *Commissioner v. Thomas*, 261 F. 2d 643 (1st Cir. 1958), the court remanded the case to the Tax Court for a determination as to whether the taxpayer there had received a large cash gift from a relative, a situation not presented here. *United States v. Bethea*, 537 F. 2d 1187 (4th Cir. 1976), a criminal tax evasion case, involved a claim that the taxpayer inherited a large sum of money which was spent during the prosecution years. The court held that the government failed to disprove this nontaxable source of

³In his brief in the court of appeals, petitioner acknowledged (page 25) that he did not have "any substantial sources of nontaxable income for 1959 through 1961."

income. Here, on the other hand, petitioner did not claim that he received an inheritance. *Whitfield v. United States*, 383 F. 2d 142 (9th Cir. 1967), is to the same effect. It likewise involved a claim that the taxpayer's net worth increases were attributable to "large monetary gifts" (383 F. 2d at 145). Under those circumstances, the government was obliged to refute that claim.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

OCTOBER 1979